

701—230.15 (423) Exemption for the sale of property directly and primarily used in processing by a manufacturer if the sale occurs as part of a contract entered into on or after July 1, 2016. The sales price of computers, machinery, and equipment, including replacement parts, and materials used to construct or self-construct computers, machinery, and equipment is exempt from sales and use tax when the property is directly and primarily used in processing by a manufacturer. For sales occurring as part of a contract entered into prior to July 1, 2016, see rule 701—18.58(422,423).

230.15(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

- a. Computers, machinery, or equipment, including replacement parts, or materials used to construct or self-construct computers, machinery, or equipment (see subrule 230.14(2));
- b. Directly used (see subrule 230.15(2));
- c. Primarily used (see subrule 230.15(2));
- d. Used in processing (see subrule 230.15(3)); and
- e. Used by a manufacturer (see subrule 230.15(4)).

230.15(2) Directly and primarily used.

a. *Directly used.*

(1) Generally. Property is “directly used” only if it is used to initiate, sustain, or terminate an exempt activity. In determining whether any property is “directly used,” consideration should be given to the following factors:

1. The physical proximity of the property to the exempt activity;
2. The temporal proximity of the use of the property to the use of other property that is directly used in the exempt activity; and
3. The active causal relationship between the use of the property and the exempt activity. The fact that a particular piece of property may be essential to the conduct of the activity because its use is required either by law or practical necessity does not, of itself, mean that the property is directly used.

(2) Examples. The following property typically is not directly used in an exempt manner:

1. Property used exclusively for the comfort of workers, such as air cooling, air conditioning, or ventilation systems.
2. Property used in support operations, such as a machine shop, where production machinery is assembled, maintained, or repaired.
3. Property used by administrative, accounting, or personnel departments.
4. Property used by security, fire prevention, first aid, or hospital stations.
5. Property used in communications or safety.

b. *Primarily used.* The primary use of property is the activity or activities for which the property is used more than half of the time.

230.15(3) Processing.

a. *Generally.* “Processing” means a series of operations in which materials are manufactured, refined, purified, created, combined, transformed, or stored by a manufacturer, ultimately into tangible personal property. Processing encompasses all activities commencing with the receipt or producing of raw materials by the manufacturer and ending at the point products are delivered for shipment or transferred from the manufacturer. Processing includes, but is not limited to, refinement or purification of materials; treatment of materials to change their form, context, or condition; maintenance of the quality or integrity of materials, components, or products; maintenance of environmental conditions necessary for materials, components, or products; quality control activities; construction of packaging and shipping devices; placement into shipping containers or any type of shipping device or medium; and the movement of materials, components, or products until shipment from the processor. “Receipt or producing of raw materials” means activities performed upon tangible personal property only. With

respect to raw materials produced from or upon real estate, “production of raw materials” is deemed to occur immediately following the severance of the raw materials from the real estate.

b. The beginning of processing. Processing begins with a processor’s receipt or production of raw material. Thus, when a processor produces its own raw material, it is engaged in processing. Processing also begins when a supplier transfers possession of raw materials to a processor.

c. The completion of processing. Processing ends when the finished product is transferred from the processor or delivered for shipment by the processor. Therefore, a processor’s packaging, storage, and transport of a finished product after the product is in the form in which it will be sold at retail are part of the processing of the product.

d. Examples of the beginning, intervening steps, and the ending of processing. Of the following, Examples A and B illustrate when processing begins under various circumstances; Example C demonstrates the middle stages of processing; and Example D demonstrates when the end of processing takes place.

EXAMPLE A: Company A manufactures fine furniture. Company A owns a grove of walnut trees that it uses as raw material. Company A’s employees cut the trees, transport the logs to Company A’s facility, store the logs in a warehouse to begin the curing process, and eventually take the logs to Company A’s sawmill. The walnut trees are real property while they are growing. Thus, no “production of raw materials” has occurred with regard to the trees until they have been severed from the soil and transformed into logs. Processing of the logs begins when they are placed on vehicles for transport to Company A’s factory. However, if the transport vehicles are “vehicles subject to registration,” they are not exempt from the fee for new registration under this rule (see subparagraph 230.14(2)“f”(7)).

EXAMPLE B: Company A from the previous example also buys mahogany logs from a supplier in Honduras. Company A uses its equipment to offload the logs from railroad cars at its facility. Company A then stores and saws the logs as previously described in Example A. Processing begins when Company A offloads the logs from the railroad cars.

EXAMPLE C: Company C is a microbrewery. It uses a variety of kettles, vats, tanks, tubs, and other containers to mix, cook, ferment, settle, age, and store the beer it brews. Company C also uses a variety of pipes and pumps to move the beer among the various containers involved in the activity of brewing. All stages of this brewing are part of processing, including fermentation or aging (the transformation of the raw materials from one state to another) as well as the storage of hops in a bin and the storage of beer prior to bottling (the holding of materials in an existing state). Any movement of the product between containers is also a part of processing.

EXAMPLE D: After the brewing process is complete, Company C places its beer in various containers, stores the beer, and moves the beer to Company C’s customers by a common carrier that picks up the beer at Company C’s facility. Company C’s activities of placing the beer into bottles, cans, and kegs, storing it after packaging, and moving the beer by use of a forklift to the common carrier’s pickup site are part of processing.

230.15(4) Manufacturer.

a. Generally. “Manufacturer” means a person that purchases, receives, or holds personal property of any description for the purpose of adding to its value by a process of manufacturing, refining, purifying, or combining of different materials, or by the packing of meats, with a view to selling the property for gain or profit, but also includes contract manufacturers. A “contract manufacturer” is a manufacturer that otherwise falls within the definition of manufacturer, except that a contract manufacturer does not sell the tangible personal property the contract manufacturer processes on behalf of other manufacturers. A business engaged in activities subsequent to the extractive process of quarrying or mining, such as crushing, washing, sizing, or blending of aggregate materials, is a manufacturer with respect to these activities. A person does not need to be primarily engaged in an activity listed in this subrule in order to qualify as a manufacturer for purposes of this rule.

b. Nonexclusive examples. Those who are in the business of printing, newspaper publication, bookbinding, lumber milling, and production of drugs and agricultural supplies are illustrative, nonexclusive examples of manufacturers. Construction contracting; repairing of tangible personal property (such as automobile engines); provision of health care; farming; transportation for hire; and the

activities of restaurateurs, hospitals, medical doctors, and those who merely process data are illustrative, nonexclusive examples of businesses that ordinarily are not manufacturers.

EXAMPLE A: Company A owns and operates a gravel pit. Company A sells the gravel extracted from the pit to others who use the gravel for surfacing roads and as an ingredient in concrete manufacture. Company A removes overlay and raw gravel from the pit and then transports the gravel to a plant where washing and sizing of the gravel take place. Company A is a manufacturer, but only with respect to those activities that occur after it extracts the gravel from the ground.

EXAMPLE B: Company B owns a manufacturing plant. Company B also owns a machine shop where it uses a metal press machine to fabricate patterns. All of these patterns are used in Company B's manufacturing plant as part of processing, and the metal press machine is used solely to fabricate these patterns. The sales price of the metal press machine is not exempt from sales and use tax under this rule because Company B does not use the metal press machine to manufacture a product for sale at a gain or profit. However, the computers, machinery, and equipment in Company B's manufacturing plant may be exempt if they are directly and primarily used in processing.

This rule is intended to implement Iowa Code section 423.3(47) "a"(1).

[ARC 2349C, IAB 1/6/16, effective 2/10/16]